From new era to New Deal

Herbert Hoover, the economists, and American economic policy, 1921–1933

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Contents

Preface *page* **xi**

Prologue: The vision of a new era in the 1920s 1

1 **The ingredients of a model of a new economics** 7
The role of economic information 8
The technocratic aspect of the attack on waste 13
The design of an economic stabilization strategy: new dimensions of fiscal policy 15
Puzzles over the place of monetary policy in macroeconomic stabilization 23
New era doctrine on wage determination and income distribution 27
Defining America's position in the international economic system 31
The end of laissez faire in the 1920s? 40

2 **Challenges to the new economics of the 1920s** 42
Critiques of the analysis of productive efficiency 42
Doubts about the high-wage doctrine 46
The special case of agriculture in the income distribution 48
Critiques of the fiscal strategy for economic stabilization 53
Doubts about economic stabilization through monetary management 58
Questions about the neomercantilist component of Hooverism 62

3 **The new economics at center stage in 1929** 65
Setting the initial agenda for economic policy 65
Organizing for action on the unfinished business 69
Concern about the stock market 71
Alternative readings of the stock market's behavior 74

4 **Activating the stabilization model in late 1929 and 1930** 78
Demand management, Hoover-style 80
Stabilization through confidence building 82

Bolstering aggregate demand through wage policy 84
The place of tax reduction in administration thinking in 1929 85
The initial responses of economists 87

5 Preliminary readings of the results of the stabilization strategy 92
Evaluating the results of 1930 92
Canvassing for further policy options 95
Appraisals from the economics profession 99

6 The unraveling of the first official model in 1931 104
Presuppositions and realities 105
Fiscal stimulus without design in 1931 108
Symptoms of disarray in the banking system 111
Storm clouds from abroad 114
The collapse of official model I 118
Realignments on the outside 120

7 Shifting course in late 1931 and early 1932 125
Bolstering the financial system: step I 126
Bolstering the financial system: step II 129
Financial reconstruction and the reformulation of fiscal policy 132
A reversion to orthodoxy? 135

8 Renewing the offensive in February and March 1932 139
The attack on the liquidity trap: February–March 1932 140
Failure of the antihoarding campaign 142
The anatomy of failure from a White House perspective 144

9 The economists and their views on policy for 1932 146
Fiscal activism in a new key 147
The economists and a more modest proposal for a public works program in 1932 151
Polling on monetary questions and the statement of the Chicago position 155
Conflicting interpretations from the heavyweights in monetary theory 157
The voice of Alvin Hansen as an exponent of neoclassical orthodoxy 162
Protests against relaxation of the antitrust laws 165
Challenges and responses 167

10 **Official model II as shaped in May 1932 and the aftermath** 169
Reformulation of the functions of the Reconstruction Finance Corporation 170
The attempt to promote official model II 174
New tools and their effectiveness (or lack thereof) 180
Rearguard actions in the final phases of the Hoover administration 185

Epilogue: Transition to the New Deal – continuities and discontinuities 189

Notes 197
Selected bibliography 231
Index 233

CHAPTER 1

The ingredients of a model of a new economics

By the standards now applied by the editors of professional journals, the model of the economy worked out in the 1920s by Hoover and his associates would be judged to be deficient in rigor. It was not presented in technical language and was totally innocent of mathematical notation. Nor did it develop an explicit distinction between what would later be identified as macroeconomics, on the one hand, and microeconomics, on the other; that was to be an innovation of another time. Nevertheless, the doctrine of the Hooverites spoke to the issues to which economic theorists have long attended: the analysis of production and exchange, of the distribution of income, of the problems of economic stability and growth, and of the nature of international trade and investment. Not only did those who envisioned the emergence of a new age in the 1920s offer an account of the way these aspects of economic activity related to one another, they also posed the further question of how the observed functioning of the economy could be improved. Economics for them, as for Keynes, was "a dangerous science" in that part of its purpose was to challenge accepted patterns of thought and action.

Hoover had set out his views on the objectives of economic policy before he began his duties at the Commerce Department. In November 1920, in his capacity as president of the newly formed American Engineering Council, he commissioned an investigation into waste in industry. This was the first inquiry of its kind and those conducting it were charged to report their findings with dispatch. Hoover's introduction to the report (which was published in June 1921) summarized its message. Americans had tolerated a major shortfall of potential output, which represented "a huge deduction from the goods and services we might all enjoy . . ." The responsibility for this outcome could not be assigned uniquely to any single cause. In part the results were attributable to the unsatisfactory functioning of the microeconomic system (in deficiencies in managerial skills and practices, in labor–management frictions); in part they were traceable to macroeconomic phenomena ("the wastes of unemployment during depression; from speculation and over-production in boom"). The task of the future was "to do a better job of it."[1] Inefficiency, whether writ large or writ small, was the enemy.

The role of economic information

In the new way of thinking, the first step in closing the gap between actual and potential production required an attack on economic ignorance. For his part, Hoover subscribed fully to Bacon's dictum that "knowledge is power," but he was prepared to add that government had a crucial part to play in gathering and distributing relevant economic facts. One of his first acts as secretary of commerce was to appoint an Advisory Committee on Statistics, with Mitchell as one of its members. Others invited to join this group were Edwin R. A. Seligman (of Columbia University), Allyn A. Young (Harvard), Walter F. Willcox (Cornell), Carroll W. Doten (Massachusetts Institute of Technology), Edwin F. Gay (then president of the *New York Evening Post*, who had formerly served as the first dean of the Harvard Business School), and William S. Rossiter (formerly the head of the U.S. Census Bureau). This was a formidable assemblage of talents which embraced some of the most respected names in American academic economics. But it was surely no accident that the membership was leavened by veterans of wartime work in government.[2] Nor could it have come as a surprise to Hoover when this group presented "urgent recommendations" in June 1921, that the statistical services of the government should be strengthened, that they be consolidated under the jurisdiction of the Department of Commerce, and that timely data on the activities of the economy's key sectors should be published regularly.

In Hoover's view, the rationale for this statistical program was compelling. In the first instance, it was a resource to aid businessmen in reducing the costs of their operations. But, in his judgment, prompt availability of reliable economic statistics also served larger social purposes. The intermediation of government in ensuring equal access to information would itself tend to perfect the market. No longer would larger firms (with a capacity to finance their own economic intelligence services) enjoy a differential advantage over their weaker rivals. Moreover, Hoover maintained that "prompt and comprehensive monthly publication of fundamental data . . . would contribute greatly" to stabilizing macroeconomic activity. Accurate information would tend "to prevent over-expansion and over-speculation, over-stocking of foreign goods, etc. At the same time it gives courage in times of depression as it tends to correct public psychology by giving a properly weighted idea of the very large continuing activities often overlooked in the midst of pessimistic outlook."[3] But this was not the end of the benefits that could be foreseen. Consumers as well as producers stood to gain. As Hoover saw matters: "competition based on fair and equal information of existing conditions would more likely result in lower prices to the consumer than competition based on uncertainty, in which each dealer must add something to his price to cover unforeseen eventualities."[4] With such arguments to commend it, a new monthly publication – the *Survey of Current Business* – was launched by the Department of Commerce in August 1921. In introducing it. Hoover stated that its purpose was "to aid the individual business firms in basing their policies upon fact, and to stabilize business in general through proper coordination of production, prices, stocks, etc."[5]

This was a modest beginning. Initially, the coverage of the *Survey of Current Business* fell far short of what Hoover hoped it would be. Not all important sectors were represented and only partial treatment could be given to many of those that were included. Hoover aspired to embrace the entire economy within his statistical network, including activities (such as agriculture and mining) which were held to be within the preserve of other governmental departments. The outputs of these sectors, once produced, were, he maintained, primarily of "commercial interest" and thus properly within the jurisdiction of the Department of Commerce. Resistance from the Departments of Agriculture and of the Interior frustrated the full realization of his ideal. But even within the more limited domain of manufacturing, distribution, transportation, and construction – activities over which the Department of Commerce could assert oversight without risk of being charged with bureaucratic encroachment – Hoover's grand design met resistance.

Within the business community, no one would contest the functional importance of economic information. But questions remained about how it should be acquired, to whom it should be made available, and about which parties should bear the costs of its collection and dissemination. By contrast with the situation during the war, when government could commandeer the information it required, government in the 1920s lacked the authority to obtain data now deemed to be essential to improved productive performance. Most of the raw material for the statistical base that Hoover sought to put in place was instead in the hands of private trade associations. From the point of view of members of these groups, such information was proprietary and inherently privileged. After all, who could reasonably argue that those who bore the costs should share the benefits with freeloaders (including departments of government)? If public officials attached importance to open access to economic data but were not equipped to produce them themselves, it was essential for government to establish an understanding with those who controlled the primary sources. This was not the least of the considerations that led Hoover to support the statistical work of trade associations and to stimulate the further growth of these organizations.

Hoover's enthusiasm for the trade association movement was not shared by the Department of Justice in the early 1920s. Indeed the very legality of the activities that he sought to encourage was challenged by its Anti-Trust Division. The existence of a potential problem had long been recognized. Bernard Baruch, for example, had advised Hoover early in his tenure of office at the Commerce Department that it was essential for the government to work out a mechanism for "supervision of industry which would permit a closer cooperation than now permitted by the Sherman Anti-trust Law," and that government should act as "a constructive and not alone a critical body."[6] Expert opinion within the Commerce Department favored the creation of a public authority empowered to pass judgment, before the fact, on the legitimacy of proposed trade association activities. Such a mechanism, it was noted, had been a part of the original conception of the act creating the Federal Trade Commission in 1914, but the language which would have conveyed this power to the commission had been stricken from the bill ultimately enacted.[7]

Within the existing legal framework, the Department of Justice was charged to police compliance with antitrust legislation and it was not prepared to endorse the collection of data by trade associations on production, shipments, inventories, and prices unless two conditions were satisfied: (1) that such information was transmitted exclusively to a government agency and not submitted to member firms and (2) that the data were presented at a level of generality that would preclude identification of the operations of individual firms. These safeguards were necessary, in the opinion of Attorney-General Daugherty, because the practice of many of these associations effectively meant that "each member reveals the details of his entire business to every other member," a situation held to be "entirely inconsistent with the normal attitude of real competitors." In his view, "the spirit of comradeship created by the confidential exchange of information of this character necessarily prevents the free competition between them which would otherwise prevail." In addition, he observed that trials of cases involving trade associations had revealed that "the members first agreed upon prices; but such a plan did not work because the members could not be relied upon to keep the agreement; and the system of exchanging statistics was adopted because it was found to be the only effective way to procure cooperation as to prices and production; and such cooperation could thus be procured even in the absence of any positive agreement."[8]

From Hoover's perspective, the proposed conditions were entirely unworkable: trade associations would no longer be willing to cooperate with the Department of Commerce in the gathering of socially useful statistics. "They would not go to the expense of collection," he noted, "if the only use that can be lawfully made of them is to transmit them to some governmental department."[9] He recognized that there was a latent danger in trade associations if members abused the information at their disposal to engage in price-fixing conspiracies, but he regarded this risk to be minor and, in most instances, likely to be neutralized by the disclosure of data to the public. In April 1922, for example, he reported that a canvass of nearly 2,000 trade associations showed that "only a small minority were engaged in those functions which lay the foundations upon which restraint of trade is suspicioned."[10] Those who took advantage of "the benevolent purpose of trade association work as a cloak to create combinations" should, he insisted, be dealt with by the full force of the law. The "real problem," as he saw matters, was "to avoid destroying the good in uprooting the evil. Men have murdered with brickbats but that is no reason for prohibiting brick houses."[11] In his considered opinion, the social benefits arising from a pooling of economic information far outweighed the likely social costs. As Hoover argued in his correspondence with Daugherty: "If business be compelled to operate without such vital information, it will naturally be forced into unscientific and highly speculative avenues."[12]

Though this controversy did not die, the discussion of the issues at stake took a different turn after June 1, 1925. On that date, the Supreme Court, in cases involving trade associations in the maple flooring and cement industries, ruled that exchanges of information among trade groups did not in themselves represent unlawful restraint of commerce. Hoover would have preferred a ruling with an added stipulation: that the data distributed to association members be made available simultaneously to a responsible government department. The court did not attach this condition, but he still counted its decision as a validation of his position.

Even so, some intricate questions remained. The Supreme Court continued to hold that attempts to reach agreements on common price and production policies were unlawful. Hoover was in full accord with this doctrine. Collusive price making was antithetical to his concept of a healthy economic order. As a practical matter, however, it was seldom easy to distinguish the impact on price formation when firms apparently acted independently (but with shared information on production and inventories) from cases in which explicit agreements on pricing policies were reached. At the level of economic theory, there was also a puzzle. The equilibrium conditions produced in a regime of perfect competitors and by a tightly organized cartel would yield one result in common: all producers would sell at the same price. Hoover was certainly aware that the lines dividing legitimate from illegitimate activity were blurred and that judgments should be based on careful investigation of the circumstances surrounding individual cases. At the same time, he left no one in any doubt about his principled opposition to price fixing. His most forceful applications of this principle, however, were in cases that he regarded as unambiguous, those in which governments were parties to price making. On this basis he vigorously opposed the practices of foreign governments in encouraging collusion among producers of raw materials that the United States imported. The same argument was invoked to attack proposals that the U.S. government should intervene in setting prices of American agricultural products.

But it was also asked whether the license accorded to trade associations might not foster greater industrial concentration and produce a structure that was incompatible with effective competition. Hoover steadfastly denied that this was the case. When challenged in June 1925 that his policy seemed calculated to accelerate the trend toward bigness, he responded: "It certainly is not. It is exactly the reverse of the truth. ... [T]he whole work of this Department ... is for the purpose of giving the small unit the same advantages which are already possessed by big business."[13] The duty of the department was to assure an open door to information for all market participants. If this could be accomplished, the competitive environment would be strengthened. This did not mean that larger units should be inhibited by virtue of their size alone. If economies of scale could be achieved by large firms which were not available to small ones, it was to be expected that the more efficient would prevail. Society had much to gain from the promotion of efficiency. But the efficient would have to win in a fair fight: one that was free of any suspicion of collusion or conspiracy.

In view of the high social yield Hoover and his associates expected from an improved flow of knowledge about the economy's performance, it is at first glance surprising that they did not extend their statistical efforts even further than they did. The latter-day observer is likely to be as struck by what was left undone as by what was done. The absence of data on the aggregative behavior of the economy, for example, is particularly noteworthy. The technique of national income accounting was, of course, then in its infancy. Hoover acknowledged that the preparation of such data was intellectually interesting and endorsed such work by private scholars.[14] It did not figure, however, among his priorities for the Department of Commerce.

The technocratic aspect of the attack on waste

As a catalyst to efficiency, government – in Hoover's judgment – had an obligation to lead the fight against wasteful practices in the production process as well as to counter deficiencies in market intelligence. The inquiry into *Waste in Industry* which he had commissioned in his capacity as president of the Federated American Engineering Societies had spoken eloquently about the costs in forgone output arising from unnecessary product differentiation and from the failure of many manufacturers to apply "best-practice" methods to the production process. The implication for governmental policy was clear: it should encourage the adoption of standardized specifications covering a wide range of industrial products and should promote productivity consciousness among manufacturers.

In Hoover's reorganized Department of Commerce, a central place was assigned to a newly created Division of Simplified Practice. In staffing it, he could tap a stream of talents flowing from Frederick Taylor's campaigns for scientific management. The charge to this unit was to develop, in consultation with representative groups from the relevant industries, a series of recommendations on steps to eliminate avoidable waste. Once agreed positions had been formulated, the department sponsored conferences and distributed pamphlets to promote their adoption. By the time Hoover left the Department of Commerce, some eighty-six such recommendations had been promulgated with results that appeared to be impressive. In the judgment of officials in the department, a "general estimate" of proved savings in "material, time, labor, and money" came to $600 million a year.[15] In an economy in which value added in the manufacturing sector was of the order of $18 billion annually, this was not a trivial sum.[16] Some of the enthusiasts for "industrial rationalization" even claimed that the new approach, if pressed to the full, could raise living standards by 20 to 30 percent.[17]

Much of this work was undramatic and largely uncelebrated. Such activities as standardizing the sizes of electrical fittings, homogenizing the threading of firehose couplings, or determining optimal radio frequencies seldom grabbed the headlines. Nevertheless, these steps toward the elimination of waste have made a major, though unquantifiable, contribution to the adaptability and the technical dynamism of the

American economy and have become part of what we now take for granted. The significance of this strand of Hooverism is perhaps better appreciated in countries that did not experience a similar technocratic intervention in the 1920s than it is in the United States.[18]

The advantages of this type of governmental intervention were not universally regarded as compelling by the business community in the 1920s. Though businessmen could readily grasp the merit of improved practices that reduced their costs, governmental guidance on the specifications of their outputs was not necessarily welcome. After all, captive markets are much easier to develop and to sustain through product differentiation than through product standardization. It is not clear whether or not Hoover was acquainted with the writings of Thorstein Veblen, who had argued that there was an inherent conflict between the engineers (whose objective was to maximize efficiency) and businessmen (whose objective was to maximize profits).[19] In light of some of the battles in which he was engaged, Hoover would have understood this point, whether informed by Veblen or not. When addressing business complaints about excessive governmental meddling in the technical details of their operations, Hoover always insisted that he neither had nor sought power to compel industrialists to adopt the Commerce Department's recommendations. At the same time he supported using government's leverage as a purchaser to encourage compliance. As one of his aides put it: "The Federal Specifications Board promulgates specifications for the government purchases and although there is of course no pressure being brought by the Department for the adoption of these by industry, nevertheless there is manifest a tendency to so adopt them by state and municipal organizations and to an increasing degree by industry."[20] The payoff to the economy at large from this effort was expected to be considerable. In the tire industry alone, for example, it was estimated in 1928 that the reduction in the number of standard tire sizes from twenty-four to sixteen would represent a savings of $25 million per year.[21]

The technocratic effort to promote cost-minimization, in Hoover's judgment, might properly take a somewhat different form in the sectors of the economy which were subject to public regulation. Here the hand of government could be more visible. Great gains were possible, he maintained, through rationalization in the railway network (which was subject to the jurisdiction of the Interstate Commerce Commission), particularly if weaker lines were merged with stronger ones. Similarly, economies were there for the taking if the Federal Power Commission could promote linkages of electric utilities into interstate grid systems.

There was thus an enlarged role for government in bringing these desirable improvements about. Moreover, government could contribute directly to making low-cost power available by using public monies to harness the water resources of interstate river systems. In such cases, the federal government could legitimately be a producer of marketable outputs, though the final step in the transaction – the distribution of electric energy to ultimate consumers – should be assigned to others (private utilities, municipalities, or cooperative associations).

Hoover's vision of the elimination of unnecessary waste embraced all of these matters. Little of the latter part of this grand design was accomplished, however, during his years at the Commerce Department. The established federal regulatory bodies preferred to operate with their procedures and at their own pace, without benefit of instruction from the secretary of commerce. Nor was Hoover successful in moving Coolidge to take action on these matters. In advance of each congressional session, Hoover proposed that the president should request legislative action to give greater authority to the Interstate Commerce Commission and to the Federal Power Commission to spur consolidations and he pressed also for federal appropriations for power production on interstate waterways at sites such as those available on the Colorado River. These proposals fell on deaf ears at the White House.

The design of an economic stabilization strategy: new dimensions of fiscal policy

To people of Hoover's persuasion, it was axiomatic that a systematic campaign to push production to its full potential called for the mitigation, if not the elimination, of cyclical disturbances. Downturns in economic activity represented a wastage that should not be tolerated in a well-ordered system. But could intelligent economic management banish such fluctuations? It was expected that an improved flow of information to producers about business conditions would itself tend to stabilize the economy by minimizing speculative excesses. But it was also maintained that this strategy could usefully be reinforced with other measures. Hoover believed that human manipulation could triumph over any alleged "laws" of economics. As he stated his position in 1923: "We are constantly reminded by some of the economists and businessmen that the fluctuation of the business cycle is inevitable; that there is an ebb and flow in the demand for commodities and services that cannot from the nature of things be regulated. I have great doubts whether there is a real foundation for this view."[22]

The importance of a technique for taming the business cycle was driven home forcefully early in Hoover's career as secretary of commerce. The year 1921 witnessed a sharp downturn in economic activity, which was accompanied by a disturbing increase in unemployment. Hoover's reaction to this situation was to convene a gathering of business and labor leaders and government officials in Washington to consider remedies for the recession. Though officially styled the President's Conference on Unemployment, it was organized on Hoover's initiative and he chaired its proceedings. Crucial to the deliberations of the conference was the groundwork laid by an economic advisory committee appointed by the secretary of commerce. Its advance report set the agenda for the subsequent discussions.[23] The primary conclusion of the economic advisers was that spending on public works, if properly timed, could smooth much of the fluctuation in business activity and employment.

A novel concept was central to an understanding of the argument supporting this finding. The impact on the economy of an accelerated public works program in times of depression, it was maintained, would be much greater than the direct stimulation it would give to incomes and jobs in the construction industry. Indirect effects would also be felt throughout the system when this added purchasing power augmented the demand for consumer goods. Nor would the expansionary effects end there. Still more jobs and more income would be created when the producers of consumer goods began to spend their enlarged incomes. The leverage for lifting the economy via public works spending was graphically depicted in charts designed to show the "multiplying effects" on employment and income which it could generate. (See Figures 1.1 and 1.2.)

In recommending this strategy to deal with depression, the committee insisted that "only necessary public works should be undertaken," projects that "would ordinarily be executed at some future time." And it added: "Public works must be on a 'commercial' basis, not a 'relief' basis, otherwise waste will result. On a 'commercial' basis men fit for the work are engaged at usual rates and wages and unfit workers are discharged. On the 'relief' basis the workers are chosen primarily because they are in need and retained whether fit or not."[24] In other words, a sound public works program would be required to satisfy the usual tests of efficiency and its purpose was to provide jobs, not handouts.

This line of thinking owed much to the work of Otto T. Mallery, a member of the Pennsylvania State Industrial Board and secretary of the state's Emergency Public Works Commission. In January 1919 Mallery had called for the development of a national policy to set aside one-

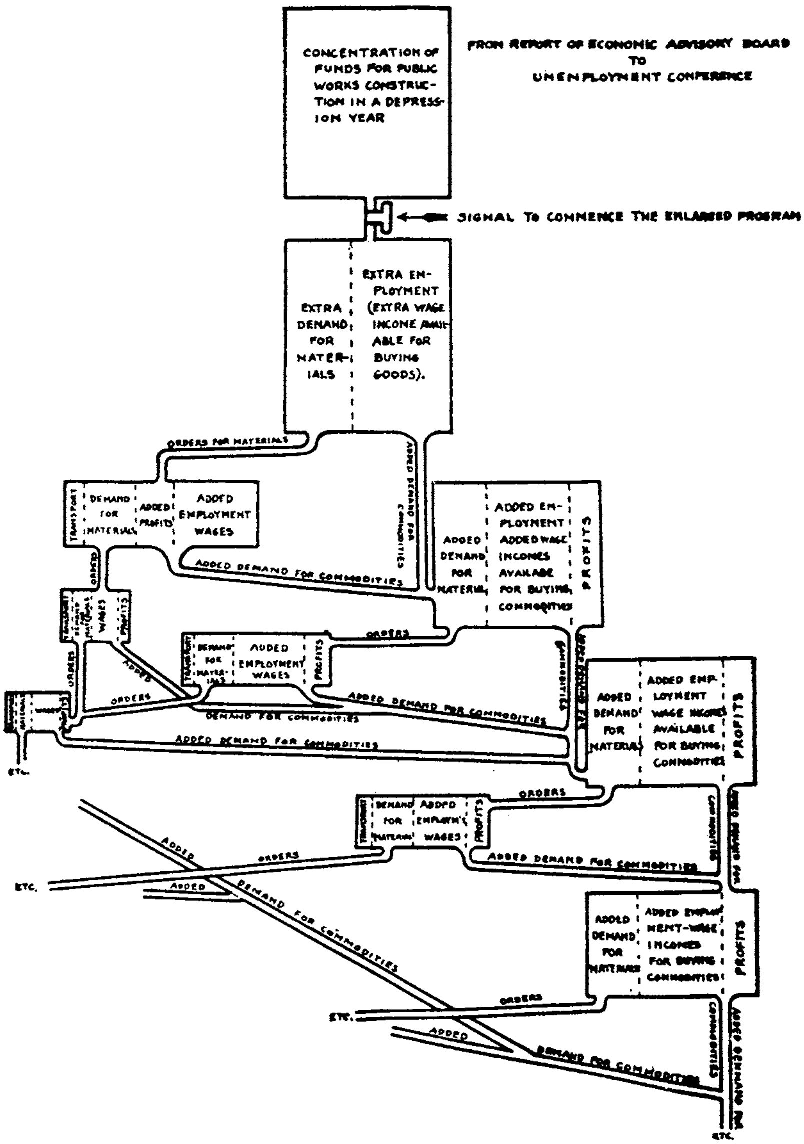

Figure 1. Aggregate stimulus to private industry caused by pressure of concentration of public works construction in depression years. Reprinted from *Report of the President's Conference on Unemployment*, 1921, p. 102.

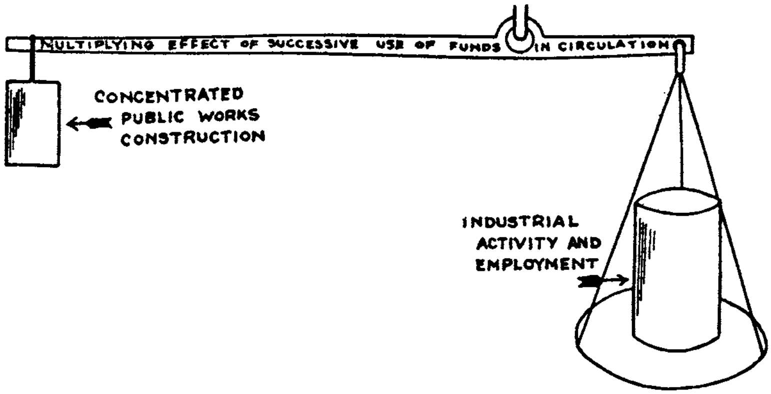

Figure 2. Manifold power of concentrated public works construction to sustain and revive industry. Reprinted from *Report of the President's Conference on Unemployment,* 1921, p. 103.

tenth of the normal volume of spending on public works as a reserve that could be drawn on to cushion a downturn in economic activity. According to his calculations at that time, five years of reserve accumulation would provide a sum adequate to "employ 800,000 workers in a bad year of unemployment at average wages for a period of three months." In view of the fact that roughly two-thirds of the total construction then undertaken on public account was performed by municipal governments, he noted that this strategy would reemploy workers in all parts of the country, and particularly in the larger industrial cities, where unemployment was typically concentrated.[25] In elaborating his version of an income and employment "multiplier," Mallery likened the effects of expenditures on public works to those associated with dropping a pebble into a pond: "the ripples . . . extend farther than the eye can see and circles of motion widen and move in all directions to the farthest shores."[26] His recommendations, he insisted, were sound for reasons that went beyond their effect in offsetting downturns in economic activity; they were also supported by considerations of elementary financial prudence. Construction undertaken in a period of slack, when prices of materials were likely to be softening, would mean that costs would be lower than otherwise would be the case.

This general strategy was endorsed by the President's Conference on Unemployment when it issued its own report in October 1921. The doctrine that the federal government should act as a catalyst to economic activity thus took on further meaning. The federal government, to be sure, was not expected to be a major spender on public works in